

Office of Legislative
Auditor General

WILLIE MAYO, CPA, CIA, CICA
AUDITOR GENERAL



500 GRISWOLD STREET
STE. 848; GUARDIAN BLDG.
DETROIT, MICHIGAN 48226
TELEPHONE: (313) 224-0924

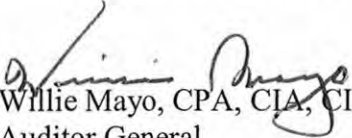
August 27, 2010

FINAL REPORT TRANSMITTAL LETTER

Honorable Wayne County Commission:

Enclosed is our final copy of the audit report of the Office of Legislative Auditor General's Operational Risk Audit on the Wayne County Employees' Retirement System. Our report is dated July 20, 2010; DAP No. 2010-57-003. The draft report was accepted by the Audit Committee at its meeting held on Tuesday, August 17, 2010, and formally received by the Wayne County Commission on August 26, 2010.

We are pleased to inform you that officials from the Wayne County Employees' Retirement System provided their full cooperation. If you have any questions, concerns, or a desire to discuss the report in greater detail, we would be happy to do so at your convenience. This report is intended for your information and should not be used for any other purposes. Copies of all Office of Legislative Auditor General's Final Reports can be found on our website at: http://www.waynecounty.com/comm_dept_auditor_reports.htm.


Willie Mayo, CPA, CIA, CICA
Auditor General

REPORT DISTRIBUTION

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Wayne County Executive



County of Wayne
WAYNE COUNTY
EMPLOYEES' RETIREMENT SYSTEM
Operational Risk Audit
July 20, 2010

REPORT SUMMARY

Why We Performed this Engagement

The Office of Legislative Auditor General (OAG) has performed an operational risk audit on the Wayne County Employees' Retirement System (WCERS) based on our 2010 audit plan submitted to County and Commission leadership. The selection of this department as part of our audit plan was based on our assessment of risk, the last time audited, and compliance with the Wayne County Home Rule Charter which requires a review of county agencies every two years.

The OAG identified five objectives for this audit engagement:

- (1) Assessment of the governance process;
- (2) Assessment of the risk management process;
- (3) Assessment of control activity and business processes;
- (4) Compliance with laws, regulations and ordinances; and
- (5) Review of revenues and expenditures for October 1, 2008 – February 28, 2010.

What We Did

We made inquiries of management, performed analytical procedures, reviewed policies and procedures and business processes, ordinances, board minutes and other documentation to validate expenditures reported in the general ledger system for the period of October 1, 2008 through February 28, 2010.

We obtained an understanding of applicable sections of the Wayne County Home Rule Charter, Enrolled Ordinance No. 86-486 and Michigan Public Act 314, as well as conducted meetings with retirement personnel and members of the Retirement Commission. In addition, we examined other relevant documents and interviewed other county personnel as deemed necessary.

Our audit was conducted and performed in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States of America and the International Standards for the Professional Practice of Internal Auditing, issued by the Institute of Internal Auditors (IIA).

Background

Organizational Structure

The Retirement Commission oversees the operations of the WCERS. The Retirement administrative staff consists of 21 employees and has a budget of \$7.5 million and all of the operating expenses are paid from the various Retirement Plans using an allocation method based on benefits derived. All of the employees are Wayne County employees and the director and deputy director are appointed by the Retirement Commission. The director and deputy director, are appointees; however, we were unable to determine who sets their salaries.

Basis of Accounting

The Defined Benefit and Contribution Plans are prepared using the accrual basis of accounting, which means the employee and employer contributions are recorded in the period in which they are due.

Annual Pension Cost

Annual contributions by Wayne County to the Defined Benefit Plan approximated \$32.5 million and \$22.5 million to the Defined Contribution Plan for the year ended September 30, 2009. The latest actuary report stated the county's pensions were 73 percent funded. As a point of reference, we have been informed that Oakland and Macomb counties and the City of Detroit Plans are funded at 100 percent or more. See Appendix A, page 32, for additional detail regarding the pension plans.

What We Found

Objective – 1 - Governance

Change in Management

The director and deputy director of the WCERS both retired in June 2010. The Retirement Commission appointed a new director effective October 1, 2010. The change in leadership

appears to be a smooth transition as the new director has a strong background in accounting and investments. He also is a current Retirement Commission member and part of the Wayne County Treasurer senior management team. In addition, the deputy director will be the acting director until October 1 and will stay on in a contractual capacity for up to a year.

Conclusion

We concluded that the governance processes of the WCERS were sufficient; however, we did note areas that could be strengthened.

WCERS Travel Policy Needs Strengthening

Condition

At the time of our audit, the director of the WCERS used his personal credit card for reservations and confirmations for travel expenses for staff and board members.

There is no formal travel reconciliation process required for reimbursement of travel expenses once travel was completed nor was supporting documentation always present in the files. While the executive director and deputy director's travel is approved in advance by the board, the deputy director is approving the executive director's travel expense reimbursement.

Conclusion

The use of a personal credit card for securing reservations for board members could limit the individuals' amount of available credit for their own personal usage. Also, not reconciling the travel expenditures upon completion of a trip could lead to fraud and abuse for individuals receiving advances in excess of actual expenditures. Additionally, not having someone in a position above the executive director approving his travel expenses violates the principles of the segregation of duties and could lead to unauthorized reimbursement of expenditures

Recommendation 2010-01

We recommend WCERS:

- (A) Obtain a WCERS corporate credit card for travel and hotel expenses for board members and the administrative staff which is to be maintained by the administration,
- (B) All travel expenses for staff should be approved by the director and all travel for the director and board members should be reviewed and approved by the Retirement Commission Board Chair, and
- (C) Administration should prepare formal reconciliations of total travel reimbursement and ensure that all supporting documentation is included in the file within a specified time after travel has been consummated.

Lack of an Audit Committee

Condition

Currently, the administrative staff solicits, negotiates and manages the external audit contract. The Retirement Commission does not play a leadership role in selecting, negotiating and managing the audit contract for WCERS' annual external audit.

Conclusion

Not having an audit committee weakens the board's oversight with respect to the integrity of the entity's financial information, its system of internal controls and the legal and ethical conduct of management and employees; thus, independency, transparency and objectivity is absent from the process.

Recommendation 2010-02

We recommend:

- (A) The Retirement Commission create an audit committee consisting of at least three board members with business backgrounds to serve on this committee,
- (B) The audit committee be responsible for approving the audit scope, evaluate all related Request for Proposals, recommend the appointment of the external auditor, overseeing the entity's financial statements and internal controls, and ensure the audit is conducted in an efficient and cost effective manner, and
- (C) The responsibilities between the board of trustees and the administration should remain separate and the external auditors should be managed and report directly to the audit committee and/or the Retirement Commission.

Retirement Commission Members Do Not Receive Formal Orientation

Condition

New members of the Retirement Commission do not receive formal orientation and training prior to assuming their role to ensure they are informed as to their board duties and fiduciary responsibilities. Upon assuming their duties, they are given an orientation binder to read and are encouraged to attend formal training sessions offered twice a year by the Michigan Association of Public Employee Retirement Systems (MAPERS) pension association.

Conclusion

Failure to properly train new board members immediately upon them taking office diminishes their ability to perform as responsible fiduciary agents of the WCERS. It is paramount that new members understand that their primary responsibilities and duties are to the participants and beneficiaries of the Plan and its interest should come first.

Recommendation 2010-03

We recommend WCERS develop a training/orientation session for all new board members outlining their fiduciary duties and responsibilities prior to assuming their role and make it mandatory to attend this session.

Retirement Commission Meeting Minutes Are Not Recorded Electronically

Condition

WCERS Commission meeting minutes are recorded manually and documented in a brief summary form by the administration director. Also, there has been no affirmation as to the authenticity, accuracy and correctness of the minutes by the administration and/or board member(s). In addition, it does not appear that the minutes are always posted to the website timely.

Conclusion

As a result of recording the minutes manually, important information could be left out during the course of the meeting and there is no backup support to settle disputes as to the accuracy of the minutes.

Recommendation 2010-04

We recommend the WCERS:

- (A) Use some sort of electronic recording apparatus to aid the executive secretary in the recording of the minutes. Once the minutes are transcribed and approved by the Retirement Commission they would then become the official minutes.
- (B) Executive secretary signs off on the minutes affirming to their accuracy and correctness before they are placed on WCERS' website.
- (C) Ensure the official minutes are posted on the WCERS' website within 7 days of approval.

Objective – 2 - Risk Management

Conclusion

WCERS appears to be adequately managing risks and have established the necessary controls over key processes to mitigate those risks. The risk management processes and its implementation and control processes are the responsibility of administrative staff and the Retirement Commission. Generally, we have concluded that risk management is satisfactory; however, we did note areas where we believe risk management and the control processes can be strengthened.

Lack of Annual Conflict of Interest Disclosure

Condition

WCERS Board adopted a Code of Ethics several years ago which states "trustees must disclose any conflicts regarding matters before the Board, not take part in any relevant deliberations, and not vote on the matter." A copy of the Retirement Commission Ethics Policy is given to each trustee; however, they are not required to file an annual conflict of interest form which is maintained on file.

Conclusion

Even though the Retirement Commission has adopted a Code of Ethics, best practices encourage an annual conflict of interest form be signed by each board member and key management officials. The completed conflict of interest form is to be placed on file to serve as a deterrent and provide evidence of continuous adherence to the Code of Ethics Policy.

Recommendation 2010-05

We recommend the Retirement Commission adopt the policy of requiring an annual conflict of interest disclosure form be signed by each board member as well as key management officials and placed in their respective file.

WCERS' Lacks Formal Investment Risk Policies

Condition

According to the WCERS external auditors report for FYE September 30, 2009, it does not have a formal policy for depository, investment custodial credit risk or interest rate risk. Further, it was stated that the Plan has deposits as of September 30, 2009, totaling \$10.8 million that is not covered by federal depository insurance because the county's pooled cash account exceeded the limits of that coverage.

Conclusion

The adoption of a formal investment policy will promote consistency and uniform guidelines to be used by board members in assessing, evaluating and safeguarding investment assets of the Retirement System. In addition, it will remove the external auditors' disclosure note to the audited financial statements that this policy is not formally documented in the WCERS accounting and administrative control processes.

Recommendation 2010-06

We recommend WCERS continue developing a formal written policy for depository, investment custodial credit and interest rate risk and plan to have the external auditor's review them before the Retirement Commission adopts them.

Board Needs to Formalize their Investment Due Diligence Policy

Condition

Based on inquiries and discussions, we were informed WCERS does not have a formal due diligence policy that is required to be followed when making decisions as to diversification, the degree of risk tolerance and performance monitoring regarding investments. Considering the overall rate of return on investments for the years ended September 30, 2009 and 2008 were disappointing, losses of 3.85 percent and 14.20 percent, respectively.

Conclusion

WCERS not having a formal due diligence policy could result in actions by the Retirement Commission that are not in the best interest of the pension system.

Recommendation 2010-07

We recommend the WCERS develop and follow a due diligence policy which sets forth guidelines governing the board of trustees/investment officer's responsibilities in activities in connection with the WCERS investment portfolio.

Lack of an Investment Committee

Condition

WCERS does not have a formal investment committee to perform due diligence and aid in the investment decisions of the Retirement Commission. Presently, all investment activities under consideration are reviewed at the Committee of the Whole.

Conclusion

A positive return on investments is critical to the financial health and funding of the pension system. Therefore, a greater return on investments results in less to be paid by the county. A committee made up of board members with administrative support staff performing the preliminary inquiries, screening and background checks could promote efficiencies and consistencies in the investment decision making process. Studies indicated that 75 percent of public retirement systems use some form of an investment committee.

Recommendation

We recommend the Retirement Commission create a formal Investment Committee to perform due diligence and screening on investments and make recommendations to the full board for acceptance or rejection based on an established set of criteria.

Objective – 3 – Control Activity and Business Processes

Conclusion

WCERS appears to be adequately evaluating and monitoring internal controls and have established the necessary controls over key processes to mitigate risks. However, we did note areas where we believe control activity processes can be strengthened.

Review of the Benefit Calculation System Program

Condition

All pension benefit calculations are performed by computer and there is no policy to periodically test the computerized output data for the benefits calculated. We were informed by

administration that the computer program was written by an independent actuarial firm several years ago; however, the computer's general and application controls have never been independently reviewed by an IT auditor.

Further, three high ranking employees of the WCERS recently retired and the retirement benefits were calculated internally and not independently reviewed by an outside consultant.

Conclusion

The WCERS benefit calculation program is used exclusively to calculate and disburse millions of dollars in retirement expenditures. Therefore, it is a good business practice to periodically have someone independently review the general and application controls on an annual basis.

Recommendation 2010-09

- (A) We recommend the WCERS periodically review the administrative policies and procedures and have an independent IT auditing firm verify the data integrity of the benefit calculations system program, as well as verification of general and applications controls to ensure the accuracy and correctness of pension calculations and payments.
- (B) We recommend the Retirement Commission establish a written policy that requires retirement benefits for all WCERS administrative staff and board members be independently calculated and signed off by an outside consultant.

Objective – 4 – Compliance with Laws, Regulations and Ordinances

The OAG reviewed WCERS compliance with the laws, regulations and ordinances that are applicable at the state and county levels of government and found no exceptions. Based on this review, nothing came to our attention that would cause us to believe that WCERS was not in full compliance with laws, regulations and ordinances that are applicable to the Retirement System.

Objective – 5 – Revenue and Expenditures

Conclusion

WCERS has an annual operating budget of \$7.5 million and administrative expenses are paid from the Plan assets of the various pension plans and the allocation of expenses are based on the number of participants in each Plan. The methodology to allocate cost between the various plans appears to be equitable and consistently applied each year. However, we did note areas where we believe control activity processes can be strengthened.

Supplemental Payments to WCERS Executives

Condition

In 2003, the Retirement Commission unanimously adopted a resolution to reimburse key executive staff members for the 14 percent pay cut imposed by the county executive on all department heads. The Retirement Commission established a separate payroll account and issued monthly payroll using the retirement plan federal identification number from January 1, 2003 through February 28, 2010 for a total of cost \$410,147 plus \$6,000 in payroll processing fees.

In addition, we have been informed that each employee wrote separate checks to the Retirement System for funding of their individual pension accounts. Administration stated there was a total of \$6,600 employee contributions and \$9,994 participatory matching made by the county which is included in the \$410,147.

However, the board received two separate opposing law firm opinions about the legality of making supplemental payments to designated WCERS employees; one opinion supported the board's legal authority to authorize supplemental payments and the other questioned its legality.

The opposing opinion raises a concern that the board may have breached its fiduciary responsibility by paying individuals "more than adequate consideration for services, therefore using the Retirement System assets other than for the exclusive benefit of their participants and their beneficiaries."

Conclusion

The Retirement Commission discontinued the supplemental payments as of February 28, 2010; however, even though three of the four participants that received supplemental payments have recently retired, we believe the questions raised in the two attorney opinion letters and the inclusion or exclusion in the Final Average Calculation for benefits should be sufficiently addressed by this body.

Recommendation 2010-010

In order to resolve this matter as soon as possible and in an effort to control costs, we recommend:

- (A) The WCERS retirement commission considers obtaining an independent opinion and guidance from Wayne County Corporation Counsel on how to address the dilemma of two opposing opinions regarding the treatment of the supplemental payments received by the four executive personnel.
- (B) Seek counseling as to whether there is a legal obligation for participatory matching of supplemental payments by the county and should they be included in the FAC benefit calculation.
- (C) Based on the legal opinion, the board needs to clearly state their position on whether the supplemental payments qualify for participatory matching and are to be included in their final average compensation upon retirement.

Lack of Intergovernmental Agreement with the Airport Authority

Condition

The WCERS provides administration support services to the employees of the Wayne County Airport Authority. However, there is no formal contract or intergovernmental agreement between the Airport Authority and Wayne County for the reimbursement of the costs for processing employee retirement transactions including administrative and loan costs. These services have been provided since 2002 and generate approximately \$80,000 in cost reimbursement annually.

Conclusion

The preparation of an intergovernmental agreement will serve to outline the administrative support the WCERS will provide, method of billing, terms of payment, and composition of expenses that are agreed upon to be reimbursed at costs.

Recommendation 2010-11

The OAG recommends the WCERS board engage Wayne County Corporation Counsel to develop a formal intergovernmental agreement between the Airport Authority and WCERS for the processing of airport employee retirement transactions and other administrative support services.

Prior Year Recommendations

Based on our review of prior year OAG reports, we have determined that all prior year recommendations have been adequately addressed and/or resolved.

Overall Views of Responsible Officials

The OAG met with the administrative staff and certain board members who generally agreed in principle with the findings and recommendations included in this report.

Noteworthy Accomplishments

-  Competent leadership.
-  Administrative staff very capable, qualified and helpful.
-  Conscientious and active board members.
-  Good reputation in the business community■

REPORT DETAILS

OBJECTIVE

The Office of Legislative Auditor General performed an operational risk audit on the Wayne County Employees' Retirement System (WCERS) based on our 2010 audit plan submitted to County and Commission leadership. The selection of this department as part of our audit plan was based on our assessment of risk, the last time audited, and compliance with the Wayne County Home Rule Charter which requires a review of county agencies every two years. Our audit objectives were: (1) assessment of the governance process; (2) assessment of the risk management process; (3) assessment of control activity and business processes; (4) compliance with laws, regulations, and ordinances; and (5) review of revenue and expenditures from October 1, 2008 – February 28, 2010.

SCOPE

The scope of this engagement was for the period of October 1, 2008 through February 28, 2010. The audit field work was performed at the Wayne County Retirement System administrative office located at 28 West Adams, Detroit, Michigan. We reviewed financial transactions from October 1, 2008 through February 28, 2010 and the last day of fieldwork was July 20, 2010.

This report is an audit in accordance with Generally Accepted Government Auditing Standards, (GAGAS) issued by the Comptroller General of the United States, and the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors (IIA). This engagement is classified as an attestation engagement which is defined in GAGAS as "an examination consisting of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on the criteria in all material respects...." The IIA standards define an assurance/attestation engagement as "an objective examination of evidence for the purpose of providing an independent assessment on risk management, control, or governance process for the organization."

METHODOLOGY

The scope of our audit required us to review the Wayne County Retirement Ordinance Section 141 of the code of ordinances and the Michigan Public Act 314 Public Employee Retirement System Investment Act PA 314 of 1965. We made inquiries of management and members of the Retirement Commission, performed analytical procedures, reviewed policies and procedures and

business processes, board meeting minutes and other documentation from the personnel of the Retirement System.

We also reviewed expenditures reported in the general ledger system for the period of October 1, 2008 through February 28, 2010. We compared revenues and expenditures for the fiscal years 2008 and 2009, noting any increases of 10 percent or more, as well as evaluated WCERS' administrative policies and procedures.

In addition, we obtained an understanding of applicable sections of the Wayne County Home Rule Charter, Enrolled Ordinance No. 86-486 and the Retirement Commission's policies and procedures as well as conducted meetings with retirement personnel and selected members of the Retirement Commission. Also, we reviewed other relevant documents and interviewed other county personnel as deemed necessary.

BACKGROUND

Organizational Structure

The Wayne County Employees' Retirement System (WCERS), is governed by the Wayne County Employees' Retirement System and created under Enrolled Ordinance No. 86-486, as amended (Retirement Ordinance) of the County of Wayne and is reported in the Wayne County CAFR as part of Wayne County's fiduciary operations.

The Retirement Commission oversees the ongoing operations of the Retirement System in accordance with the Retirement Ordinance. The WCERS is responsible for assisting all Wayne County employees make a smooth transition from employee to retiree. They monitor investments, disperse all payroll and benefit payments and maintain all the records for past employees.

The Retirement System office is staffed with approximately 21 full-time employees from the county's civil service classifications, including the director and deputy director. All personnel costs for WCERS employees are paid by the Retirement System as a direct reimbursement to the county. The employees receive their compensation from the county and are reported under the county's employer federal identification number. The director and deputy director, are appointees; however, we were unable to determine who sets their salaries.

Basis of Accounting

The Defined Benefit and Contribution Plans are prepared using the accrual basis of accounting. This means the employee and employer contributions are recognized in the period in which they are due.

Investment Authority

The Wayne County Employees' Retirement System investments, which are under the control of the Wayne County Retirement Commission, are subject to statutory regulations imposed under the Michigan Public Pension Investment Act 314 of 1965, as amended (Act 55, P.A. 1982), and investment policies established by the Retirement Commission.

The investment Act incorporates the prudent person rule and requires investment fiduciaries to act solely in the interest of the participants and beneficiaries. The Retirement Commission has authority to invest the Plan's assets in common and preferred stock, obligations of the United States, its agencies, or U.S. government sponsored enterprises, obligations of any state or political subdivision of the state having power to levy taxes, bankers' acceptance, certificate of deposits, commercial paper, repurchase agreements, real and personal property, mortgage, and certain other investments.

Plans Description

The Wayne County Employees' Retirement System, a single-employer public employee retirement system, provides five defined-benefit retirement options, four of which are contributory (together, the Defined Benefit Plan) and a Defined Contribution Plan. The retirement system provides retirement, survivor, and disability benefits to substantially all Wayne County, Airport Authority, and Court employees.

In addition, the county's Retirement Commission administers the Wayne County Circuit Court Commissioners Bailiffs' Retirement System, a defined-benefit plan.

Each year the Retirement Commission issues three externally audited financial statements, one for the Defined Benefit Plan, one for the Defined Contribution Plan and the Wayne County Circuit Court Commissioners Bailiffs' Retirement System. See Appendix A for additional detail regarding the pension plans – page 32.

Annual Pension Cost

Annual contributions by Wayne County to the Defined Benefit Plan approximated \$32.6 million and \$22.5 million to the Defined Contribution Plan for the year ended September 30, 2009. The county is not required to make an annual retirement contribution to the Wayne County Circuit Court Commissioners Bailiff's Retirement System (Bailiffs' Plan). This plan is funded by the State of Michigan.

According to the CAFR as of September 30, 2009, the Defined Benefit Plan is 73 percent funded and the Bailiffs' Plan is 174 percent funded. As a point of reference, we have been informed that Oakland and Macomb counties and the City of Detroit Defined Benefit Plans are funded at 100 percent or more.

Pension Benefits

Benefits are paid monthly over the member's or survivor's lifetime, after meeting normal retirement or duty disability retirement requirements, which vary by Plan option. Benefits are established and may be amended by changes in collective bargaining agreements, or modification to the Retirement Ordinance.

GOVERNANCE

The governance process is considered one of the most important elements of internal controls. According to auditing/accounting literature, governance (also known as the control environment) is the foundation for all other components of internal controls. The control environment sets the tone of an organization, program, or activity, influencing the control consciousness of its employees. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include: the integrity, ethical values and competence of the organization's employees; management's philosophy and operating style; the way management assigns authority and responsibility; and organizes and develops its employees; and, the attention and direction provided by the commissioners.

The absence of good governance structures and lack of adherence to basic governance or management principles increases the risk of loss, fraudulent financial reporting, and misappropriation of an organization's assets and resources. Good governance is one of the key controls to reduce the risk of management overrides.

Change in Management

The director and deputy director of the WCERS both retired in June 2010. The Retirement Commission appointed a new director effective October 1, 2010. It appears there will be a smooth transition with the change in leadership as the new director has a strong background in accounting and investments, is a current Retirement Commission member and part of the Wayne County Treasurer senior management team. In addition, the deputy director will be the acting director until October 1 and the deputy director along with the executive secretary will stay on in contractual capacities for up to a year.

Conclusion

Based on inquiries, discussions and observations made by us we have generally concluded that the control environment, organizational structure, philosophy and ethical values of WCERS leadership appear to be sufficient to meet the department's goals and objectives. However, we did note areas where we believe the governance process can be strengthened.

WCERS Travel Policy Needs Strengthening

Condition

At the time of our audit, the director of the WCERS used his personal credit card for reservations and confirmations for travel expenses for staff and Retirement Commission board members.

There was no formal travel reconciliation process required for reimbursement of travel expenses once the travel was completed. We found instances in which supporting documentation was not always present in the files. While the executive director and deputy director's travel is approved by the board, the deputy director approves the executive director's travel expense reimbursement. Additionally, we noted WCERS travel policies and procedures have not been reviewed and/or updated for several years.

Criteria

State of Michigan Public Act 266, which authorizes and regulates credit card transactions for local governmental units, and best practices, stresses the importance of proper controls and handling credit card usage. Public Act 266 sets criteria and guidelines which must be followed.

Best practices also suggest that reconciliations take place immediately after travel is completed and expense files should contain documentation to support all expenditures. Further, all board member travel should be approved by someone that is objective and independent of the process.

Cause

Management stated that the approval of travel reimbursement was brought before the board of trustees, and the idea was rejected without further discussion.

Consequences

The use of a personal credit card for securing reservations for board members could limit the individuals' amount of available credit for their own personal usage. Also, not reconciling the travel expenditures upon completion of a trip could lead to fraud and abuse for individuals receiving advances in excess of actual expenditures. Additionally, approving the travel expenses of one's supervisor violates the principle of the segregation of duties and could lead to unauthorized reimbursement of expenditures

Recommendation 2010-01

We recommend WCERS:

- (A) Obtain a WCERS corporate credit card for travel and hotel expenses for board members and the administrative staff which is to be maintained by the administration,
- (B) All travel expenses for staff should be approved by the director and all travel for the director and board members should be reviewed and approved by the Retirement Commission Board Chair, and
- (C) Administration should prepare formal reconciliations of total travel reimbursement and ensure that all supporting documentation is included in the file within a specified time after travel has been completed.

Lack of an Audit Committee

Condition

Currently, the administrative staff solicits, negotiates and manages the external audit contract. The Retirement Commission does not play a leadership role in selecting, negotiating and managing the audit contract for WCERS' annual external audit.

Criteria

Best practices and the Government Accountability Office recommend public sector entities consider the benefit of using audit committees. The audit committee is an integral element of public accountability and governance. It plays a key role with respect to the integrity of the entity's financial information, its system of internal controls and the legal and ethical conduct of management and employees. Typical audit committee responsibilities will include approving the overall audit scope, recommending the appointment of the external auditor, overseeing the entity's financial statements and internal controls, and ensuring the audit is conducted in a cost effective manner.

Cause

Officials within the WCERS stated board members have various backgrounds. Additionally, it was stated that the deputy director and other senior administration team members are CPA's and they are qualified to select and manage the external auditors and review the audited financial statements.

Consequences

Not having an audit committee weakens the board's oversight with respect to the integrity of the entity's financial information, its system of internal controls and the legal and ethical conduct of management and employees; thus, independency, transparency and objectivity is absent from the process.

Recommendation 2010-02

We recommend:

- (A) The Retirement Commission create an audit committee consisting of at least three board members with business backgrounds to serve on this committee,
- (B) The audit committee be responsible for approving the audit scope, evaluate all related Request for Proposals, recommend the appointment of the external auditor, overseeing the entity's financial statements and internal controls, and ensure the audit is conducted in an efficient and cost effective manner, and
- (C) The responsibilities between the board of trustees and the administration should remain separate and the external auditors should be managed and report directly to the audit committee and/or the Retirement Commission.

Retirement Commission Members Do Not Receive Formal Orientation

Condition

New members of the Retirement Commission do not receive formal orientation and training prior to assuming their role to ensure they are informed as to their board functions and fiduciary responsibilities. According to one board member, upon assuming their duties, they are given an orientation binder to read. Also, at the first board meeting, they are encouraged to attend the training sessions offered twice a year by the Michigan Association of Public Employees Retirement System (MAPERS). However, this training only takes place twice a year and the member may have to assume their role as much as five months prior to this training.

Criteria

Government Finance Officers Association best practices for governance states as part of a board's education, new Retirement Commission members should receive orientation training explaining their responsibilities and fiduciary duties, as well as the duties of WCERS' staff and agents (e.g., actuaries, attorneys, advisors, and fund managers). A program of continuing education needs to be developed and participation should be a mandatory requirement.

Cause

There is no requirement for new board members to attend orientation/education sessions.

Consequences

Failure to properly train new board members immediately upon taking office diminishes their ability to perform as responsible fiduciary agents of the WCERS. It is paramount that new members understand that their primary responsibilities and duties are to the participants and beneficiaries of the Plan and its interests should come first. Without thorough orientation and training, members could run the risk of not having the expertise to make informed decisions regarding policies and perform other crucial Retirement Commission functions; as well as expose WCERS to unwarranted lawsuits.

Recommendation 2010-03

We recommend WCERS develop a training /orientation session for all new board members outlining their fiduciary duties and responsibilities prior to assuming their role and make it mandatory to attend this session.

Management Response

Management stated that orientation/education for board members is provided at the MAPERS conferences which are held twice a year. At this conference, there are training sessions provided by pension attorneys. During the first board meeting that includes new board members, the information on the MAPERS conferences are provided.

Retirement Commission Meeting Minutes Are Not Recorded Electronically

Condition

WCERS Commission meeting minutes are recorded manually and documented in a brief summary form by the administration director. Also, there is no affirmation as to the authenticity, accuracy and correctness of the minutes by the administration and/or board member(s). In addition, it does not appear that the minutes are always posted to the website timely.

Criteria

The official minutes should accurately reflect the meeting. Best practices suggest some mode of electronic recording of board meeting minutes for use in transcribing the minutes to provide a reference point if there is a disagreement over an item in the draft minutes. Once the minutes have been transcribed and approved by the board, they are the official minutes of the meeting. There should also be an affirmation statement posted to the WCERS website once approved by the board.

Cause

According to WCERS officials, the Retirement Commission did not want the meetings recorded electronically. The official further indicated that in the WCERS' Rules of Procedure – Section IV Minutes states: "Minutes shall be taken by the executive secretary of the board. Minutes shall reflect the actions taken by the Board but shall not be taken verbatim."

Consequences

Important information, debates and conversations could be left out or unintentionally omitted during the course of the meeting, especially since some meetings are lengthy and sometimes there may be other distractions and conversations going on simultaneously.

Recommendation 2010-04

We recommend the WCERS:

- (A) Use some sort of electronic recording apparatus to aid the executive secretary in the recording of the minutes. Once the minutes are transcribed and approved by the Retirement Commission they would then become the official minutes.

- (B) Executive secretary signs off on the minutes affirming to their accuracy and correctness before they are placed on WCERS' website.
- (C) Ensure the official minutes are posted on the WCERS' website within 7 days of approval.

RISK MANAGEMENT

Risk management is another critical internal control component. Every organization faces a variety of risks from external and internal sources that must be identified and assessed. Risk management is the identification and analysis of relevant risk, which exists within the organization as a whole, as well as within its individual components (departments, divisions, programs, etc.) regarding the achievement of the organization's objectives. After an assessment is formalized, a basis for determining how the risks should be managed and mitigated to a reasonable level of acceptance should be established.

The identification of risk is a necessary component to installing compensating controls, where required, to enhance the probability of achieving the organization's objectives and protecting the interest of the stakeholders. The first step in the risk management process involves identifying the various threats affecting an operation and determining the magnitude of the potential loss associated with those threats using a qualitative or quantitative methodology.

According to the IIA standards, "risk management and its implementation and control processes are the responsibility of management and the board of directors."

Conclusion

WCERS appears to be adequately managing risks and have established the necessary controls over key processes to mitigate those risks. The risk management process and implementation and control processes are the responsibility of the administrative staff and the Retirement Commission. Generally, we have concluded that risk management is satisfactory; however, we did note areas where we believe risk management and the control processes can be strengthened.

Lack of Annual Conflict of Interest Disclosure

Condition

WCERS Board adopted a Code of Ethics several years ago which states "trustees must disclose any conflicts regarding matters before the Board, not take part in any relevant deliberations, and not vote on the matter." A copy of the Retirement Commission Ethics Policy is given to each trustee; however, they are not required to file an annual conflict of interest form which is maintained on file.

Criteria

Even though the Retirement Commission has adopted a Code of Ethics, best practices encourage an annual conflict of interest form be signed by each board member as well as key management officials and placed on file to serve as a reminder and provide evidence of continuous adherence to the Code of Ethics Policy.

Cause

The Retirement Commission feels that being aware of the policy was enough and saw no need to sign an annual conflict of interest form.

Consequences

The signing of the conflict of interest form will serve as a deterrent and periodically remind the board members of their obligation and provide documentation to support compliance with the adopted Code of Ethics.

Recommendation 2010-05

We recommend the Retirement Commission adopt the policy of requiring that annual conflict of interest disclosure forms be signed by each board member as well as key management officials and placed in their respective file.

WCERS' Lacks Formal Investment Risk Policies

Condition

According to the WCERS external auditors report for FY September 30, 2009, WCERS does not have a formal policy for depository, investment custodial credit risk or interest rate risk. Also, the report stated that the Defined Benefit and Contributions Plans have deposits as of September 30, 2009, of \$10,404,195 and \$400,732, respectively, that were not covered by federal depository insurance because the county's pooled cash account exceeded the limits of that coverage.

Criteria

Deposits – Custodial credit risk for deposits is the risk that, in the event of a bank failure, the Plan's deposits may not be returned to the Plan. State of Michigan statutes require that certificates of deposit, savings accounts, deposit accounts and depository receipts be made with banks doing business and having a place of business in the State of Michigan that are also members of a federal or national insurance corporation.

Investments – Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, WCERS will not be able to recover the value of its investments that are in the possession of an outside party. Investment securities are exposed to custodial risk if the securities are uninsured, are not registered in the name of the entity, and are held by either the counterparty or the counterparty's trust department or agent, but not in the entity's name.

Interest Rate Risk – There is a risk that the market value of investments will vary unfavorably as a result of a change in interest rates. The investment portfolio should be structured so that

securities mature to meet cash requirements for ongoing operations, to avoid the need to sell securities on the open market prior to maturity. There are risks inherent in all deposits and investments, and disclosures are required to provide users of governmental financial statements with information to assess common risks inherent in deposit and investment transactions. In regard to interest rate risk, the investment portfolio should be structured so that securities mature to meet cash requirements for ongoing operations.

Cause

January 2007, was the last time the WCERS investment policy statement was revised.

Consequences

Not having this policy does not allow the financial statement users to be informed about deposit and investment risks that could affect WCERS' ability to provide services and meet its obligations as they become due. In addition, it will remove the external auditors' disclosure note to the audited financial statements that this policy is not formally documented in the WCERS accounting and administrative control processes.

Recommendation 2010-06

We recommend WCERS continue developing a formal written policy for depository, investment custodial credit and interest rate risk and plan to have the external auditor's review them before the Retirement Commission adopts them.

Board Needs to Formalize their Investment Due Diligence Policy

Condition

Based on our inquiries and discussions we were informed WCERS does not have a formal due diligence policy that is required to be followed when making decisions as to diversification, the degree of risk tolerance and performance monitoring regarding investments. Considering, the overall rate of return on investments for the year ended September 30, 2009 was a loss of 3.85 percent, compared to a loss of 14.20 percent for the year ended September 30, 2008 as noted in the audited financial statements, an investment due diligence policy would be important.

Criteria

Best practices suggest that due diligence be exercised by investment officers acting in accordance with written procedures and an investment policy. Prudent management requires those investing (the Board or Investment Officer) to diversify its investments and conduct regular, periodic examinations to monitor the performance of investments.

Cause

WCERS failed to include these policies in their Investment Policy Statement revised January 2007. Also, a due diligence policy should set guidelines governing investment officer's responsibilities in conducting activities in connection with the investment portfolio.

Consequences

Not having a due diligence policy in place could result in the board or agent of the pension system either intentionally or unintentionally through their management actions, or lack thereof, cause the assets of the system to perform under expectations.

Recommendation 2010-07

We recommend the WCERS develop and follow a due diligence policy which sets forth guidelines governing the board of trustees/investment officer's responsibilities and activities in connection with the WCERS investment portfolio.

Lack of an Investment Committee

Condition

WCERS does not have formal investment committee to perform due diligence and aid in the investment decisions of the Retirement Commission. Presently, all investment activities under consideration are reviewed at the Committee of the Whole.

Criteria

Best investment practices suggest an investment (sub) committee (usually consisting of three members), review all investment programs to ensure compliance with policies of the WCERS. This committee's duties could include such things as recommending asset allocations, approving active and passive strategies, evaluating the use of internal versus external management, selecting and reviewing investment managers, appointing and reviewing custodians and recommending and reviewing investment consultants. According to a report we reviewed, 75 percent of public retirement systems use some form of an investment committee. The committee would also advise the board on the preparation and maintenance of an investment policy that would work in concert with the investment officer to perform their due diligence in such areas as diversification strategies, portfolio and overconcentration.

Cause

At present, all investment decisions are made by the full board and they rely on outside consultants and the administration director to assess and recommend investments to them.

Consequences

Not having a separate investment committee limits the amount of due diligence that is performed and the assurance that potential investors have undergone an initial screening process.

Recommendation 2010-08

We recommend the Retirement Commission create a formal Investment Committee to perform the due diligence and screening on investments and make recommendations to the full board for acceptance or rejection based on an established set of criteria.

Management Response

The Board of Trustees has the Committee of the Whole, which are their investment review members; they review potential investments before they are recommended to the full board.

CONTROL ACTIVITIES

Control activities are policies, procedures, practices, techniques, and mechanisms that help ensure that management directives are carried out. These actions help ensure that necessary actions are taken to address risks to achievement of the organization's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, and reviews of operations and performance, security of assets and segregation of duties. The need for control activity is established in the risk management process.

Control activities can be preventive or detective. Preventive activities are designed to deter the occurrence of an undesirable event, while detective activities are designed to identify undesirable events that do occur and alert management about what has happened. This enables management to take corrective action promptly.

Conclusion

WCERS appears to be adequately managing risks and has established the necessary controls over key processes to mitigate those risks. However, we did note areas where we believe control activity processes can be strengthened.

Review of the Benefit Calculation System Program

Condition

The pension benefit calculations are all performed based on a computer program. There is no policy that requires the periodic testing of the computerized output data for the benefits calculated. We were informed by administration that the computer program was written by an independent actuarial firm several years ago; but, the computer's general and application controls have never been independently reviewed by an IT auditor. Most of the other computerized programs are tested annually by the external auditors in conjunction with their testing of the Wayne County Department of Technology department general and application controls. Based on a review of the board minutes, we noted the Retirement Commission received two to three complaints per month for various reasons.

Further, three high ranking employees of the WCERS recently retired and the retirement benefits were calculated internally and not independently reviewed by an outside consultant.

Criteria

Good business practices and managerial principles suggest that benefit calculations are periodically verified by someone other than the administrative staff. In our review of a report on operational risks in public pension systems and controls to mitigate those risks, there were several risks related to actuarial computer programs. The control recommended to mitigate the risk was to hire an independent firm, audit the systems, or develop a quality assurance program to validate the data.

Cause

The WCERS does not have a periodic verification audit either internally or externally for the benefit calculation system. WCERS was never made aware of any potential risk associated with the computerized benefit calculation program. In addition, the complaints were due to many employees retiring at the same time and changing between various plans.

Consequences

Failing to ensure that the data integrity exists in the benefit system program could lead to costly errors in the calculation of employee pension benefits which could go undetected for years.

Recommendation 2010-09

- (A) We recommend the WCERS periodically review the administrative policies and procedures and have an independent IT auditing firm verify the data integrity of the benefit calculations system program, as well as verification of general and applications controls to ensure the accuracy and correctness of pension calculations and payments.
- (B) We recommend the Retirement Commission establish a written policy that requires retirement benefits for all WCERS administrative staff and board members be independently calculated and signed off by an outside consultant.

COMPLIANCE WITH LAWS, REGULATIONS AND ORDINANCES

Conclusion

The OAG reviewed WCERS compliance with the laws, regulations and ordinances that are applicable at the state and county levels of government and found no exceptions. Based on this review, nothing came to our attention that would cause us to believe that WCERS was not in full compliance with laws, regulations and ordinances that are applicable to the Retirement System.

REVENUE AND EXPENSES

Conclusion

WCERS has an annual operating budget of \$7.5 million and all administrative expenses are paid from the Plan assets of the various pension plans based the number of participants in each plan. The methodology to allocate cost between on the various plans appears to be equitable and consistently applied each year. In addition, a list of all expenditures is submitted to the Retirement Commission for approval before administration processes them for payment. We did note areas where we believe control activity processes can be strengthened.

Supplemental Payments to WCERS Executives

Condition

In 2003, the Retirement Commission unanimously adopted a resolution to reimburse key executive staff members for the 14 percent pay cut imposed by the county executive on all department heads. The resolution further stated that “all payments made pursuant to this resolution shall be included in the calculations of benefits including retirement benefits calculations and contributions.” The Retirement Commission established a separate payroll account and issued monthly payroll drawn on the pension plan account. Furthermore, the Retirement Commission used the retirement plan federal identification number from January 1, 2003 through February 28, 2010 - for a total cost of \$410,147 plus approximately \$6,000 in payroll processing fees.

In addition, we have been informed that each employee wrote separate checks to the Retirement System for retirement contribution to their individual pension accounts. WCERS stated there was a total of \$6,600 employee contributions and \$9,994 participatory matching made by the county which is included in the \$410,147.

However, the board received two separate opposing legal opinions about the legality of making supplemental payments to designated WCERS employees; one opinion supported the board’s legal authority to authorize supplemental payments and the other questioned its legality.

The opposing opinion raises a concern that the board may have breached its fiduciary responsibility by paying individuals “more than adequate consideration for services, therefore using the Retirement System assets other than for the exclusive benefit of their participants and their beneficiaries.”

Criteria

According to the Charter, the Retirement Commission is vested with the fiduciary responsibility for the proper administration, management and operation of the Retirement System and for interpreting and making effective its provisions. Further, Michigan Public Act 314, states that: an investment fiduciary may use a portion of the system's income to defray the costs of investing, managing, and protecting the assets of the system; may retain investment and all other services necessary for the conduct of the affairs of the system; and may pay reasonable compensation for those services.

Cause

The intent of the Retirement Commission was to restore the 14 percent reduction in compensation imposed by the executive branch on all county-wide department heads which included the four WCERS employees. Additionally, the Retirement Commission relied on a legal opinion before passing a resolution authorizing the supplemental payments to the four employees.

Consequences

The retirement board's action resulted in a total cost of \$410,147 for the four WCERS employees from January 1, 2003 through February 28, 2010. In addition, the board's resolution stated the payments shall be included in their calculation of "Final Average Compensation (FAC)." We were not able to compute the FAC cost of this additional benefit to the County in this report.

Further, the WCERS is potentially exposed to the risk of a lawsuit related to the treatment of the FAC calculation by any one of the four employees. This is due to the Retirement Commission's passing of a resolution stating that these payments qualified for inclusion in their retirement benefit calculation.

Recommendation 2010-10

In order to resolve this matter as soon as possible and in an effort to control costs, we recommend:

- (A) The WCERS retirement commission considers obtaining an independent opinion and guidance from Wayne County Corporation Counsel on how to address the dilemma of two opposing opinions regarding the treatment of the supplemental payments received by the four executive personnel.
- (B) Seek counseling as to whether there is a legal obligation for participatory matching of supplemental payments by the county and should they be included in the FAC benefit calculation.
- (C) Based on the legal opinion, the board needs to clearly state their position on whether the supplemental payments qualify for participatory matching and are to be included in their final average compensation upon retirement.

Lack of Intergovernmental Agreement with the Airport Authority

Condition

The WCERS provides administration support services to the employees of the Wayne County Airport Authority. However, there is no formal contract or intergovernmental agreement between the Airport Authority and Wayne County for the reimbursement of the costs for processing employee retirement transactions including administrative and loan costs. These services have been provided since 2002 and generate approximately \$80,000 in cost reimbursement annually. In addition, the current director of the airport resigned as of June 30, 2010; therefore, now is an appropriate time to negotiate an agreement under new leadership.

Criteria

Good business practices state that a formal contract or agreement should be in place specifying the terms and conditions for the reimbursement of costs.

Cause

Management stated they did not implement a formal contract or agreement with the Airport Authority because they are a separate authority from the county.

Consequences

Not having a formal agreement in place for the reimbursement of costs could lead to disputes regarding the amount to be reimbursed.

Recommendation 2010-11

The OAG recommends the WCERS board engage Wayne County Corporation Counsel to develop a formal intergovernmental agreement between the Airport Authority and WCERS for the processing of airport employee retirement transactions and other administrative support services. ■

Prior Year Recommendations

Based on our review of prior year OAG reports, we have determined that all prior year recommendations have been adequately addressed and/or resolved.

Overall Views of Responsible Officials

The OAG met with the administrative staff and certain board members who generally agreed in principle with the findings and recommendations included in this report.

Noteworthy Accomplishments

- ✚ Competent leadership.
- ✚ Administrative staff very capable, qualified and helpful.
- ✚ Conscientious and active board members.
- ✚ Respected reputation in the public pension administration community.

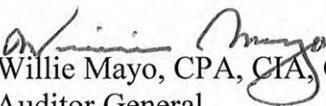
OAG CONCLUSION

We performed an audit of the WCERS operations by making inquiries and examining documentation related to governance, risk management, control activities, and revenue and expenses. We also reviewed WCERS compliance with the laws, regulations and ordinances adopted by the State of Michigan, Wayne County Commission, and the Retirement Commission. There were no exceptions noted.

We generally concluded that the objectives of the department are being met; however, we noted some areas that could be strengthened in governance, risk management, control activities, and revenue and expenses. There are a total of eleven recommendations which we have classified as significant deficiencies and should be addressed by WCERS administrative staff and the Retirement Commission.

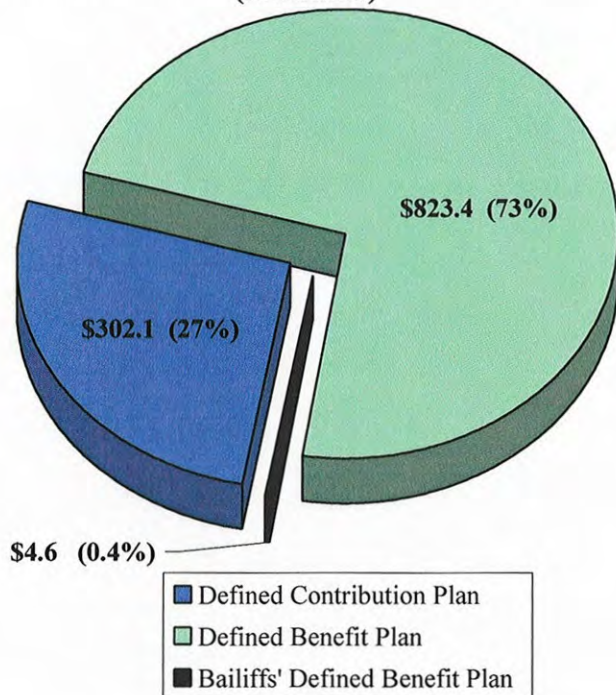
A corrective action plan will be requested from the WCERS approximately 30 days after the Commission formally receives the report to assess action taken or intended regarding the recommendations.

This report is intended solely for the information and use of the Wayne County Employees Retirement System officials, the Retirement Commission and the Wayne County Commission and is not intended to be and should not be used by another other than these specified parties. This restriction is not intended to limit the distribution of the report, which is a matter of public record.

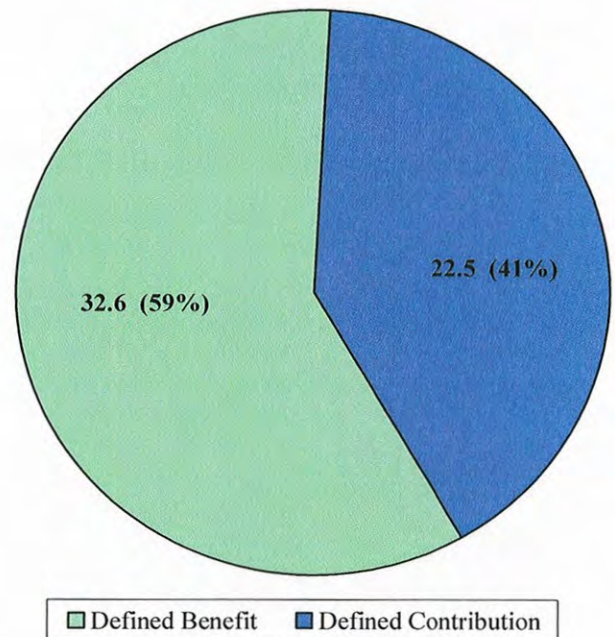

Willie Mayo, CPA, CIA, CICA
Auditor General

APPENDIX A DEFINED BENEFIT CONTRIBUTIONS FOR FISCAL YEAR 2009

**FY 2009 Wayne County Employees Retirement System
Net Assets Held In Trust For Pension Benefits
(In Millions)**



**FY 2009 County Contributions
To Each Defined Plan
(In Millions)**



- **Defined Contribution Plan** – is a plan in which an employee's benefits during retirement depend on the contributions made by the employee to the plan, the employer's matching contribution and investment performance of the assets in their account based on the employee's investment selection.
- **Defined Benefit Plan** – is a type of pension plan in which an employer promises to pay a specific monthly benefit on retirement that is predetermined by a formula based on an employee's earning history, tenure of service and age, rather than on investment returns.
- **Level of Funding** - the county is 73 percent funded on its general Defined Benefit Plan and 174 percent on the Bailiffs' Defined Benefit Plan as of September 30, 2009. There is no funding level requirement other than the county's matching contribution for the Defined Contribution Plan and the county is current with all contribution payments to this Plan as of FYE September 30, 2009.